Compliments of The First National Bank in Minneapolis, Minn.
Correspondent of The National City Bank of New York

1812

THE NATIONAL CITY BANK OF NEW YORK

1928

Economic Conditions
Governmental Finance
United States Securities

New York, April, 1928

Capital Increase, The National City Bank of New York

THE Board of Directors of The National City Bank of New York have taken the preliminary steps for submitting to shareholders at a special meeting to be held April 24, 1928, a proposal to increase the capital stock of the Bank from $75,000,000 to $90,000,000 by offering a new issue of 150,000 shares to the shareholders of record at the close of business April 28, 1928, for subscription pro rata to their holdings, at $400 per share. The proposal contemplates that the $45,000,000 so to be made available after payment is made for the capital stock of the Bank at par, shall be used for increasing the stock of The National City Company from $25,000,000 to $45,000,000 and the surplus of The National City Company from $25,000,000 to $50,000,000.

In his letter to the stockholders, dated March 24, the President indicated the purposes of the proposed increase in capitalization as follows:

> As regards the Bank, this increase of capital is in line with our traditional policy, referred to on the occasion of the last previous increase, of maintaining a larger ratio of capital and surplus to deposits than is dictated by general banking practice. As regards The National City Company, the Board are of the belief that these additional capital resources should be provided to permit the Company to acquire from time to time for short or long term investment account, bonds, stocks, or other equity interests, the holding of which will facilitate the development of its regular business or generally inure to the benefit of the Bank and the Company, and that such resources can be thus profitably employed.

General Business Conditions

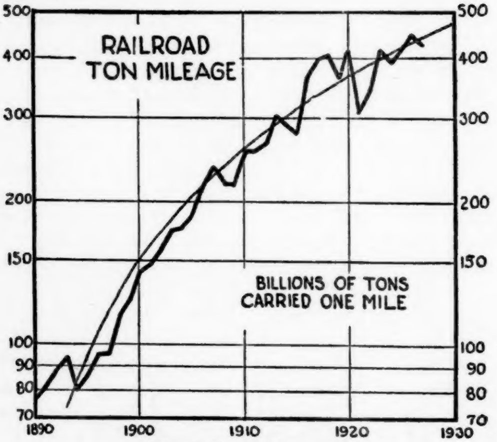
The month of March has witnessed further improvement in the condition of general business, but favorable and unfavorable influences continue so mixed that business men are still in a good deal of a quandary as to the trend. The steel and automobile industries have had a good recovery, and building is being projected in large volume throughout the country, but thus far there has not been the follow-up in other lines that was hoped for by this time. With so pronounced a recovery, however, in these key groups, the prospects for increased activity in other industries are decidedly more hopeful. An expansion of commercial borrowing at banks and increasing employment are underlying evidences of general betterment.

Undoubtedly, the outburst of bull speculation on the Stock Exchange has done a great deal to dispel the gloom that had been accumulating, even though the prophetic qualities of the market in its present mood are open to question. For some time the market has appeared to be influenced by forces other than the trend of business. Easy money, a wide public participation, and the locking up of large blocks of stock in the strong boxes of investment trusts and individual investors have made the market more than ordinarily open to manipulation, and recently the tide of speculation has swung strongly in favor of the bulls. Without question a large part of the advance in stock prices which has occurred in recent years can be justified on the basis of the increased earning power of our leading corporations, as well as the inevitable adjustment of yields to the lower level of interest rates. The line, however, between justifiable advance and inflation is a fine one to draw, and the unfortunate part of such widespread indulgence in speculation as has been taking place is that the public becomes heavily involved, so that any decline in prices may affect the expenditures of many people in the commodity markets. Probably never before have so many people been interested in the stock market as today, a fact which must be reckoned with in any attempt to size up the business outlook.

As far as business itself is concerned, the situation is spotty, but no weaknesses appear serious enough to occasion real misgivings. The steel trade is operating at about 85 per cent of capacity, with production promising to round out the first quarter somewhat higher than a year ago and prospects good for April. Demand for steel from the automobile, building, and agricultural implement trades is active, and with a revival of railroad buying a good year would seem assured.

Railroad Traffic and Business

So important is railway buying in the national market, not only for steel but other products, that general business might easily turn upon it. During the past year railway purchases have been light, due partly to decreasing traffic and earnings, and with car loadings still running below a year ago, prospects for this year have not been altogether promising. It is a highly significant fact, however, that only once in the record running back to 1890 have there been two successive years of declining railway traffic, that period being 1914 and 1915, when business was prostrated by the opening of the war. It is true that in some cases recovery in the second year was slight, but nevertheless there was always a gain.



(Curved line indicates trend)

We know of no more striking evidence of the irresistible tendency of this country to rapidly regain its stride than these figures depicted graphically in the preceding diagram. Unless the record of the past proves to be a false guide, car loadings this year will exceed those of last year, which in itself would be an evidence of business recovery and which might well result in a revision upwards in the amounts which the railroads are intending to spend for new equipment.

The Situation in Different Industries

During the first two months of the year contracts awarded throughout the country for building amounting to $892,500,000 were 15 per cent greater than a year ago, and reports from architects and builders indicate business ahead as far as they can see. Automobile production in many plants is making new high records, and the industry as a whole is doing better than a year ago. While the effect of keen competition and lower prices of cars on the earnings of many of the manufacturers is still a matter of conjecture, it is clear that the industry can be counted on for a large employment of labor and consumption of materials through the first six months at least.

The lumber industry is responding to the upturn in building with continued heavy gains in production, sales, and unfilled orders as compared with a year ago. In textile lines, silk goods mills are unusually active, while the demand for rayon appears to have no limit.

The Department of Labor has just completed its survey of unemployment which it estimates at close to 1,900,000 workers, a figure considerably less alarming than the 3,000,000 to 4,000,000 frequently quoted. Employment, moreover, is on the up-grade, reports of the Philadelphia Federal Reserve Bank and of the New York State and Illinois Labor Departments indicating an enlargement of payrolls during February. Though the gains no doubt are partly due to seasonal causes, it is encouraging to note that in the Philadelphia district the increases were larger than in the corresponding period a year ago, while in Illinois they compared with a downtrend in February last year. Seasonal recovery in the clothing and shoe industries in preparation for Spring trade has helped to swell the ranks of the workers, while recovery in the steel and automobile plants, and greater activity in meat packing, have also been important factors. At the automobile centers the employment figures are making a particularly good showing, the Detroit Employers' Association in their report of March 20 indicating a gain of 7 per cent over a year ago, despite the comparatively low production of Ford. At Toledo, factory employment has been running at record levels, with some plants reported as advertising for workers. Taking the country as a whole, however, the employment gains have not yet been large enough to absorb the labor surplus, and unemployment is still a disturbing factor in numerous localities, though one which there is reason to hope will become less so as the Spring season advances.

Unsatisfactory spots in business continue most conspicuous in the cotton spinning, the coal mining, and the oil industries. In the cotton trade, curtailment of production is still being practiced. Coal is suffering from the old trouble of too many mines. As regards oil, while the situation is regarded as past the worst, thanks to determined efforts to control production and the reduction in gasoline stocks, little hope is seen for any great improvement so long as the potential supplies are so much in excess of demand. Retail trade in general merchandise has not been particularly encouraging, due probably to unemployment and adverse weather conditions, and

wholesale trade likewise has shown much irregularity, though a pick-up in sales of machine tools has been commented upon favorably as possibly reflecting an expansion of manufacturing activity.

Business Fundamentally Sound

More important, however, than the condition of any individual industry is the solid foundation of commercial and financial strength upon which business rests. No one who has looked over the annual reports of our leading corporations for the past year can fail to be impressed with the well nigh impregnable position which most of these reports reveal. Never before has business been so solidly entrenched in cash and so unencumbered with inventory. A few over-extended spots can be found, as always, but nothing which in the event of liquidation would cause more than a local disturbance.

Aside from some seasonal goods which have not moved well, due to unfavorable weather, there is no distress merchandise pressing for sale. Foreign trade is in healthy condition. Some of the depressed sections of the country, such as the Northwest and the cattle raising territory, are coming back. Agriculture is in better shape, due to the higher monetary yield of last year's crops, with returning purchasing power clearly evidenced by the prosperity of the big mail order houses and of the agricultural implement business. Basic factors, in short, continue sound and can be counted on to exert their influence in favor of better business.

The 1927 Business Profits

As usual during the past year a great deal has been said about the unsatisfactory character of business profits. The year has been frequently referred to as one of "profitless prosperity" as though we had been simply going through the motions of doing business without making any money. As usual, the actual figures, while they show a decline, have fallen a long way short of justifying all the hard-times talk that has been circulating.

Following is a table showing the earnings last year of 709 leading industrial corporations that have published reports which indicates a level 7.9 per cent below that of 1926 but slightly above that of 1925, up to that time considered a very good year for business. A total is also given showing the earnings of the General Motors Corporation and of all companies, excluding General Motors. The latter figures, while making a less favorable showing than the first ones, are nevertheless by no means bad, the 1927 figures showing a decrease of 10.5 per cent from 1926 and of 4.1 from 1925. The point may reason-

(000's Omitted)

No.	Industry	1925	1926	1927	% Change 1926-27	% Change 1925-27
10	Agricultural Implements	$ 35,249	$ 43,583	$ 44,664	+ 2.5	+ 26.7
14	Amusements	21,862	38,731	39,777	+ 2.7	+ 81.9
15	Apparel	10,857	11,011	12,589	+ 14.3	+ 16.0
27	Automobile and Trucks	275,570	313,465	329,230	+ 5.0	+ 19.5
32	Auto Accessories	62,293	54,280	48,549	— 10.6	— 22.1
29	Building Materials	69,288	57,992	48,387	— 16.6	— 30.2
33	Chemicals and Drugs	96,175	120,384	129,377	+ 7.5	+ 34.5
16	Coal Mining	8,749	15,522	9,276	— 40.2	+ 6.0
14	Copper Mining	24,147	34,994	30,484	— 12.9	+ 26.2
23	Cotton Manufacturing	3,459	1,820 Def.	10,490	+	+203.3
21	Electrical Equipment	72,556	80,974	80,579	— 0.5	+ 11.1
13	Flour and Bakery	72,557	83,734	91,046	+ 8.7	+ 25.5
24	Food Products	75,466	87,278	88,698	+ 1.6	+ 17.5
10	Heating and Plumbing	27,014	27,892	26,561	— 4.8	— 1.7
88	Iron and Steel	191,322	238,696	183,498	— 23.1	— 4.1
11	Leather and Shoes	24,304	20,276	31,920	+ 57.2	+ 31.4
33	Machinery	41,441	47,779	38,780	— 18.8	— 6.4
10	Meat Packing	34,825	32,701	14,555	— 55.4	— 58.1
65	Merchandising	167,141	173,593	189,013	+ 8.9	+ 13.1
30	Non-ferrous Metals (Exc. Copper)	86,069	90,845	81,019	— 10.8	— 5.9
24	Office and Home Appliances	53,617	59,666	62,706	+ 5.1	+ 16.9
11	Paper and Products	8,287	6,652	6,759	+ 1.6	— 18.4
54	Petroleum	339,007	394,505	212,405	— 46.2	— 37.3
15	Printing and Publishing	25,131	25,364	29,775	+ 17.4	+ 18.5
17	Railway Equipment	25,485	47,592	37,444	— 21.3	+ 46.9
15	Rubber	72,874	34,935	50,818	+ 45.6	— 30.3
9	Shipping	7,407	5,441	8,381	+ 54.0	+ 13.2
9	Silk Manufacturing	10,392	6,465	4,858	— 24.8	— 53.8
20	Sugar	12,494	6,196	19,684	+218.0	+ 57.5
24	Tobacco	103,575	113,276	117,743	+ 3.9	+ 13.7
5	Woolen Manufacturing	2,033	1,997 Def.	3,299	+	+ 62.3
38	Miscellaneous	61,321	61,521	65,642	+ 6.7	+ 7.0
709	Grand Total	$2,121,967	$2,331,526	$2,148,001	— 7.9	+ 1.2
	General Motors Corp.	126,617	194,645	235,105	+ 20.8	+ 85.7
708	Total excluding General Motors	$1,995,350	$2,136,881	$1,912,896	— 10.5	— 4.1

ably be raised as to whether it is not unfair to exclude General Motors figures simply because that company happens to include in one organization a number of subsidiary companies which otherwise would be included individually. It is a factor in the entire situation and was in the preceding years.

A further interesting fact revealed in the figures is that if we exclude from the calculation the heavy losses sustained by the oil companies due to conditions peculiar to that industry, we find that aggregate earnings of the remaining companies were approximately equal to those of 1926 and 8.5 per cent above those of 1925.

Railroads experienced a relatively poor year, with a decline of 11.9 per cent in net earnings, due to falling off in traffic together with an increase in expenses, largely wages. Seventy-eight telephone companies and 51 other public utilities, on the other hand, increased their earnings 10.7 per cent to a new high record.

The results demonstrate the compensating influences at work during the year. Despite substantial declines in profits in such important lines as oil, railway equipment, iron and steel, meat packing, etc., enough lines were going ahead to materially offset these losses.

The Coal Industry

A strike in the bituminous coal industry began on April 1, 1927, at the expiration of the wage agreement known as the Jacksonville scale, which went into effect three years before.

The last previous strike was on April 1, 1922, when the operators attempted to secure a reduction from the wages which had been reached during the war time and in 1919 and 1920. As the result of Government intercession, however, work was resumed at the scale which had been in effect, and the Jacksonville scale continued the same rates.

The position of the miners' union was strengthened during the war, and at the time of the strike in 1922 the division of production between union and non-union miners was approximately sixty-five per cent to the former and thirty-five per cent to the latter. When the Jacksonville agreement was entered upon the division was approximately sixty per cent to the union and forty per cent to the non-union mines. By this time, however, the surplus of mine capacity and mine labor was so great that non-union operations at lower wages were steadily increasing, and before the end of 1924 union mines were quite out of the competition unless favored by transportation charges. The famous correspondence between Mr. Lewis, head of the United Mine Workers, and Mr. Stone, head of the Brotherhood of Locomotive Engineers, over wages in West Virginia mines owned by the Brotherhood occurred in 1924. Mr. Stone described his situation and that of other would-be union operators when he said:

> We want to run a union mine, and expect to run one if at all, but it is impossible to do so when the non-union fields around us can produce coal so much more cheaply, and have a monopoly on the entire market.

Non-union mines enlarged their operations and thousands of union miners shifted to non-union mines. When the Jacksonville agreement expired, naturally few operators were willing to renew it. Large stores of coal had been accumulated in anticipation of a stoppage of union operations, and with an increase of non-union mining and some falling off of consumption, no scarcity of coal has been experienced. In Indiana, Illinois and certain other western fields temporary agreements were made for continuing operations under the Jacksonville scale. The total production of coal in the eleven months from April 1, 1927, to March 1, 1928, was about 430,000,000 tons against 534,000,000 in the corresponding period of the preceding year, and might have been larger if there had been need for it. At the present time the division of production is estimated at eighty per cent non-union to twenty per cent union. The capacity of the mines in non-union districts probably is not much below the normal consumption of the country.

This is the recent history of the industry now under investigation by the Senate Committee on Interstate Commerce. Thus far the Committee has been giving attention mainly to the deplorable conditions existing among the families of strikers in the fields where the competition is most acute. Distress almost certainly results from unemployment, but the purpose of an investigation under the Federal authority presumably is to find out what is wrong with an industry and what, if anything, the Federal Government can do to correct it.

Superfluous Mines and Miners

What is wrong with the bituminous coal industry is a matter of common knowledge. Mr. John L. Lewis, President of the United Mine Workers, was the first witness before the Committee and began his testimony with the statement that "the bituminous coal industry is notoriously over-developed," and that two Government commissions within the last eight years had condemned the expansion as regarded both capital assets and man power. This statement recognizes that conditions are unsatisfactory from the standpoint of proprietors as well as of employes. The former have paid the penalty for their part in this expansion by enormous losses. The capital spent in the development of a coal mine cannot be withdrawn; if it cannot be made to pay a profit where it is it is hopelessly sunk. No more

drastic punishment for mistaken business judgment can be imagined.

The proprietors individually are more helpless under the conditions than the wage-earners, for it is not impossible for the latter to find other employment. The proprietors are unable under the anti-trust laws to cooperate in any manner which will restrain competition, and it is more than doubtful if they would be able to do so effectively even if there were no anti-trust laws.

The comments of the Senators in charge of the investigation indicate a belief that if all coal operators would recognize the union, adopt the union wage scale and make it the basis of coal prices the problem would be solved. One of them, (who it may be added is also a prominent advocate of the McNary-Haugen bill) is reported as saying that the principles of the Watson-Parker act, under which railroad wages are regulated and have been generally advanced in the past year, should be applied to the coal industry. The railroad industry differs from the coal industry in several particulars, one being that it has not been confronted with superfluous railroads and superfluous employes. They may exist, but they do not constitute a problem, and in fact the number of railway employes has been reduced by several hundred thousands in recent years as the result of efforts to place that industry on a more economical basis.

An Industry on Stilts

The theory advanced about the coal industry seems to be that unemployment should be eliminated by raising the price of coal, so that all mines will be able to pay the union scale and all miners will have employment. If this were done the production of coal would be far in excess of the demand, and in order to avoid competitive conditions the working time would have to be uniformly reduced, wages and prices being made high enough to afford an acceptable standard of living despite the idleness. Of course, no such uneconomic system could be maintained by agreement, even if there were no laws against it. Some of the mines can be worked at lower costs than others and some are more eligibly located. Naturally the owners of these would not accept arbitrary restrictions for the sake of inferior competitors, and there is no reason from the standpoint of the public interests why they should do so.

It is not in the public interest that coal miners shall receive less than a fair wage in comparison with wages in other industries, hazards and all factors considered, but it is one thing to pay good wages for labor and something different to support unnecessary men in the industry. Coal production is a basic industry, the cost of coal entering into the cost of all other products, not only in original production but in transportation. There is unremitting pressure upon every other industry to eliminate waste and get itself upon an economical basis, and the other industries have a right to insist that the coal industry shall do the same.

The Natural Regulation of Industry

Price and wage changes are the means by which economic law keeps the industrial system in balance, moving people about from where they are not needed to where they will be more useful and better paid. Nobody likes to be under economic pressure, but every development in industry puts somebody under pressure. It is a constant condition of progress. The improvement in farm machinery and in the science of farming has made it possible for a smaller number of workers on the farms to supply the required quantity of farm products, with the result that agriculture has been under pressure and the farm population has been reduced in recent years. Reference has been made to the reduction in the number of railroad employes, which has been from 2,022,832 in 1920 to 1,764,000 in 1927, although the ton miles of freight traffic increased in the same time from 410,306,000,000 to 474,682,000,000. A reduction of 258,000 in the number of miners employed and seeking employment would materially improve the situation for those remaining. The railroads are accused of using their influence to break down the miners' union, but they deny that this has any other basis than the fact that they have declined to buy coal at high prices when they could buy at lower prices. Coal is the second item in railway expenditures, and in view of the resolute manner in which they have reduced their own working forces it is not strange that they should be unwilling to pay for superfluous employes in producing their coal.

The primary function of an industry is not to provide jobs, but to render its services in the most efficient manner, for every reduction in costs and prices increases the buying power of the public, so that consumption increases and the demand for labor on the whole remains unchanged, as proven by the history of machine development.

The Economic Remedy

The logical remedy for the coal situation would seem to be in having the price fall low enough to eliminate all but the number of mines required to supply the demand for coal, with a reasonable margin for expansion, and have so much of the working force as may be needed concentrated at these low cost mines, with reasonably constant employment at good wages. This is the situation to which the industry tends under unrestricted competition.

The process is severe, but is there any other way of getting to a sound basis?

Plans for selling agencies and other means of limiting competition are discussed, but they are not a remedy for idle time. Numerous consolidation proposals are reported to be under consideration, and so far as they may effect economies in production or distribution they will make for stability, but they must look for success to low costs and not to price control on an artificial basis. New organizations which are loaded up with high-cost producers, or with heavy capitalization representing values unrealizable for a long time, will find themselves handicapped, perhaps to the extent of not being in the first division of low-cost producers. There is no stability or security for industries except upon a low-cost basis, or for wages unless the industries are upon a stable basis.

Money and Banking

The tremendous turnover in the stock market and sensational advances in the prices of speculatively favored shares have far transcended in importance other developments in money and banking during the past month, and indeed have been a dominating feature of the entire business and credit situation. From a level of prices already high, judged by all previous standards, the market during the past month has been swept forward in the most irresistible rush yet exhibited in these years of amazing bull markets.

What have been the forces behind this market and when will it all end are questions being asked on every hand.

The Rise Prior to 1927

It is to be remembered first that prices of a great many stocks and bonds were depressed by the war. This was notably true of railway issues and also of the public utilities whose costs of operation were affected by advancing prices of labor and materials but whose income did not advance commensurately owing to public control of rates. Interest rates, moreover, were high, due to the demands for capital to finance the war, and this, together with the other adverse factors, had the effect of greatly depressing values.

After the war there began a great readjustment of security prices. Though the movement was interrupted temporarily by the inflation and deflation of 1919-1920, this tendency of readjustment has been making steady progress. With the adoption of a more friendly attitude on the part of the public and of rate-making commissions, the prices of railroad and public utility company shares and bonds have been coming back into favor. In the industrial field it was inevitable that the share values would come to reflect the higher reproduction value of plants and equipment, due to the advance in prices. Still more important has been the enormous increase in the productivity of industry as a result of which earnings have been plowed back into the properties and earning power has been vastly increased. A third and not less important factor has been the gradual decline in interest rates, due to the accumulation of capital and savings, to which the prices of securities must conform.

The Effect of Gold Imports

There is also the influence of gold imports. Following is a table showing the monetary gold stock of the United States at the end of each month since 1922. The figures allow for gold earmarked for foreign account, that is, gold set aside out of our stocks and marked for foreign ownership though not actually shipped. Inasmuch as gold produced in the United States is nearly all absorbed in the arts, the changes shown in monetary stocks are almost entirely due to imports and exports.

(In millions of dollars)

Month	1922	1923	1924	1925	1926	1927	1928
January	3,685	3,953	4,289	4,423	4,412	4,564	4,373
February	3,723	3,963	4,323	4,369	4,423	4,586	4,359
March	3,760	3,970	4,364	4,346	4,442	4,597	....
April	3,764	3,982	4,411	4,350	4,438	4,610	....
May	3,771	4,028	4,455	4,361	4,433	4,608	....
June	3,785	4,050	4,488	4,365	4,447	4,587	....
July	3,829	4,079	4,511	4,370	4,471	4,580	....
August	3,855	4,111	4,521	4,383	4,473	4,588	....
September	3,873	4,136	4,511	4,382	4,466	4,571	....
October	3,888	4,167	4,509	4,407	4,473	4,541	....
November	3,906	4,207	4,527	4,397	4,477	4,451	....
December	3,929	4,244	4,499	4,399	4,492	4,376	....

It will be observed that from January, 1922, to November, 1924, our gold stocks increased from $3,685,000,000 to $4,527,000,000, or by $842,000,000. During 1925 we sustained a considerable loss of gold due largely to our heavy foreign loans, some of the proceeds of which were withdrawn in gold, but in 1926 and early 1927 the movement was again in this direction. On April 30, 1927, our gold stocks reached a new peak of $4,610,000,000, making the net increase $925,000,000 since the beginning of 1922.

This inflow of gold, while partly offset by the operations of the Reserve banks, could not but make itself felt in our credit structure. It came too fast, however, to be absorbed by the commercial business of the country, and consequently it has gone to that quarter which will always take credit at a price—namely the security markets. Thus we see that whereas from 1922 to April, 1927, the commercial loans of the reporting member banks increased by $1,027,000,000, or 13.6 per cent, the loans of these banks on stocks and bonds increased by $2,120,000,000, or 57.5 per cent, and their investments in securities by $2,359,000,000, or 66 per cent. With this golden flood poured into the market it was inevitable that security prices should undergo a great rise.

The Gold Movement Reversed

This is all very well to account for the rise which occurred up to the middle of 1927 when our reserves were being constantly fed by new gold supplies from abroad, but how about the period since September during which we not only have not gained in gold, but have actually lost by some $300,000,000?

During the first six months of last year, the United States had a net balance of gold imports, including earmarkings, amounting to $56,000,000. Gold was coming to us in large volume from Europe, not only endangering us with inflation, but threatening a serious drain upon European countries, and particularly London, the European monetary capital.

In order to protect the exchanges and avert these undesired gold imports, the Federal reserve banks adopted an easy money policy made effective by a general reduction of rediscount rates and large purchases of Government securities in the open market. This action, undertaken primarily to facilitate international stabilization, had the effect of further stimulating the security markets where the pace about the middle of last year had begun to show signs of flagging. The Reserve banks, it can be safely assumed, had no wish to encourage further speculation, but such was an unavoidable result of their easy money policy, adopted because of the larger ends in view.

Prompt reflection of this change of policy was seen in the last six months of the year. With the lowering of money rates in this country, a large share of the burden of financing international movements of trade was shifted from London to New York. For a time there was a tendency for banking funds to flow from this country to foreign centers for employment. Our market was rendered more attractive for the flotation of foreign securities, and a very large amount of this business was done. As a result, the pressure on the exchange usually incident to Fall commodity shipments was lifted, foreign exchanges were in demand, rose to the gold point, and gold began to flow out of this country in substantial volume.

The Reserve Banks and Gold Exports

Ordinarily, just as an inflow of gold tends to enlarge the basis of credit and permit expansion, so an outflow of gold, if allowed to exert its normal influence on the market, tends to lessen the basis of credit and bring about contraction. Had it not been for the action of the Reserve banks last Fall in extending new credit to the market in proportion as credit was withdrawn through gold exports, we must inevitably have experienced a contraction at that time which would have reflection in the security markets. As it was, however, the Reserve banks, still guided largely by international considerations, supplied the credit as it was needed, and expansion went on. With a declining demand for funds for commercial purposes, excess credit went into the security markets, resulting in new high levels of brokers' loans at the year-end, and causing no little uneasiness in the minds of conservative observers. By these it was recognized that a fundamental change had occurred. In previous years the expansion of credit had accompanied an expansion in the gold reserves. Now, however, the expansion was taking place in the face of a decrease in the gold reserves. It was clear that this was a situation which could not continue indefinitely, and that it was only a question of time before the Reserve banks would find it necessary to reverse their policies.

Nor was such action long delayed. With the Fall season of heaviest pressure on the exchanges over, and with a general easing of money conditions in Europe, the Reserve banks began early in January to take steps to tighten the money market. First evidence of this appeared in the liquidation during January and early February of approximately $200,000,000 of their holdings of Government securities by which they absorbed an equivalent amount of credit from the markets, followed by a program of successive rate advances at the different regional banks until by early March all the Reserve banks were back on a 4 per cent basis. This selling of securities and advances in discounts were accompanied by a moderate firming in open market rates for money.

The February Decline in Stocks

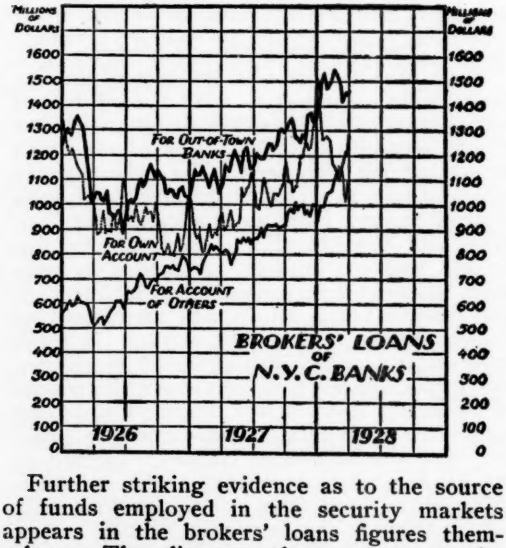
That these activities on the part of the Reserve banks were viewed with a good deal of nervousness by the speculative community was clearly evidenced by the action of the stock market during February. The long advance which stocks had had during 1927, the high level of brokers' loans and indications of Congressional disapproval of these totals, the uncertain business outlook, all tended to augment the bearishness engendered by the Federal reserve action which was interpreted as aimed directly at the stock market. Accordingly, after a period of irregularity stocks ran into considerable liquidation about the middle of February, and brokers' loans went off by something over $100,000,000 from the peak. But here the movement stopped. Instead of the heavy plunge downward in prices which followed the development of a somewhat similar situation at the beginning of 1926, when brokers' loans declined by nearly $700,000,000, this movement came to an end almost before it got started. What was the reason for this resistance?

Sources of Funds for Stock Speculation

The answer, in our opinion, lies largely in the money situation. The chief difference be-

tween 1926 and 1928 is in the fact that 1926 opened with an active commercial situation competing with the stock market for funds, while 1928 opened with a sub-normal commercial demand, as a result of which funds, for want of employment elsewhere, were available to the market in volume sufficient to stem the decline.

The evidence that business has had a surplus of funds over its needs is quite conclusive. There has been a further marked falling off this year in the amount of currency in circulation. January is always a month of a large return flow of currency to the banks from the holiday trade, but this year the return flow was much larger than usual (due probably in part at least to lessened factory payrolls), so that by the end of January the total outstanding was approximately $150,000,000 lower than a year previous. Nor has the total increased any since then. When money is returned in this way to the banks from the pockets of the people, the banks in turn deposit it in the Reserve banks where it adds to their reserve balances and under our present system of bank reserves becomes in effect the basis of new loans many times the original reserve deposits. Had it not been for this retirement of currency there is no question but that the measures instituted by the Reserve banks to tighten the market would have been much more effective than was actually the case.



Further striking evidence as to the source of funds employed in the security markets appears in the brokers' loans figures themselves. The diagram above compares the weekly figures reported by New York City banks to the Federal Reserve Bank, classified as to whether lent for own account, for account of out-of-town correspondents, or for account of others, this last item including loans for corporations and individuals.

Here it is shown that the principal additions to brokers' loans this year have been money placed by New York banks for account of corporations and individuals, the total of which by March 21 had increased $357,000,000 since January 1, and $774,000,000 since the low point of 1926. Loans placed for out-of-town banks, which also reflect the surplus of funds flowing here for investment, have likewise increased this year, while those placed by New York banks for their own account have declined and are at the lowest levels since last summer.

Credit Supplies Not Unlimited

What then are the fundamental facts of the present situation? We have a volume of speculation built upon an excess of funds above commercial needs. Long familiarity with easy money appears to have created the impression that the supply of funds is inexhaustible. The fact that no great firmness in money has followed Federal reserve selling of Government securities or advances in rediscount rates seems to have given many people the idea that the Federal reserve authorities are powerless to influence the situation. As a matter of fact nothing could be further from the truth than these two suppositions. It should be understood that there is never any appreciable supply of money that is really idle. Banks get their lending power into use somehow even though they have to take unsatisfactory rates. Since this is the case, if expansion is to go on in the stock market, the supporting credits in the last analysis can only come from one or more of three sources—gold imports, funds released from business, or expansion of Federal reserve credit.

During much of the advance in stocks of the past five years the funds came from gold imports, but that source is now closed and gold is flowing away from this country. Within the past few months funds released from business have been an important factor. There are, however signs of reviving commercial demand both in the recovery of basic production and in a substantial increase in the commercial loans of reporting banks. Already these influences have imparted a firmer tone to the money market evidenced in the slightly advanced rates for time money, bankers acceptances, and commercial paper. Should these influences continue and be accompanied by an increased currency demand the effect on the supply of money available for speculation might be substantial.

Attitude of the Reserve Banks

It is true that the lending powers of the Reserve banks are still very large, and in this fact industry and trade has a reassuring guaranty against unpleasant surprises. It is not tc be assumed, however, that the Reserve banks

will regard with favor a use of their facilities for the purpose of expanding stock market credits, particularly at a time when their reserves are being diminished by gold exports.

Notwithstanding a widely prevalent impression to the contrary, the Reserve banks were never in more complete control of the situation than they are today. Volume of member bank indebtedness to them has been averaging close to $500,000,000, or over $50,000,000 above that of a year ago. Besides bills discounted, the Reserve banks hold approximately $335,000,000 of acceptances bought in the open market and $400,000,000 of Government securities—in all a total of bills and securities averaging over $1,200,000,000, or $150,000,000 to $200,000,000 more than a year ago. They have but to contract these advances to the market, and the effect upon money rates and the volume of credit outstanding would be immediate.

Undoubtedly the Reserve banks would be averse to taking action that would precipitate anything in the nature of a crisis. At the same time it should be understood that under our banking laws credit cannot be expanded without additional reserves on which to base it. A theory which has considerable currency, to the effect that bank deposits are growing rapidly as the result of abounding prosperity and that they constitute the reservoir from which credit is drawn, is very misleading. Bank deposits, whether created by loans or by savings, must have certain legal reserves behind them, and when there are no surplus reserves deposits cannot be increased. In such a situation even the natural growth of deposits cannot occur unless the banks are able to procure additional reserves, which may necessitate the calling of loans.

In order to have the view of the situation which is before the Federal Reserve authorities it is to be considered that New York is now a reserve center for foreign banking institutions and that the holdings of such institutions in this market in the form of bank credit and short term paper are very large. The Federal Reserve Bulletin, the organ of the Federal Reserve Board, in its number for June, 1927, estimated these holdings by foreign central banks at as much as $1,000,000,000, using the following language:

Of the total holdings of foreign assets by central banks, a considerable proportion is held in the United States. While there is no way to determine this proportion precisely, there is reason to believe that it is large, and that perhaps as much as $1,000,000,000 of the operating reserves of foreign central banks is in the form of dollar exchange.

In its official Report for the year 1926, dated February 17, 1927, the Federal Reserve Board referred to this situation and commented upon its bearing upon Federal Reserve policy in the following language:

These dollar balances of foreign central banks, whether they are invested or kept on deposit, are in liquid form and subject to immediate withdrawal at any time. If they were to be withdrawn, in gold in whole or in part the demand for the gold, though it would first be felt by the commercial banks, both member and non-member, would promptly reach the Federal reserve banks as the only holders of gold in any considerable amount. These balances are, therefore, potential sources of demand upon the Federal reserve banks for gold out of their reserves, the central banking reserves of the United States, which have thus become indirectly a part of the reserves against bank credit and currencies in other countries. The existence in America of these foreign balances consequently presents a condition in the banking situation to be taken into account in determining the Federal reserve system's credit policy with a view to maintaining the country's banking system in a position to meet demands for gold from abroad without disturbing business and credit conditions in this country.

It will be seen that the above estimate referred only to the holdings of foreign central banks in this market and did not include other deposits. The Department of Commerce in its "international balance sheet" issued last year showed that in addition to bank deposits and short investments in this market foreign citizens also owned large amounts of American securities deposited with American agents. To a considerable extent these probably are held as security for loans, and on the whole may be considered as to a great extent permanent holdings; nevertheless, the amount might be affected by changing conditons in our security markets.

It is not to be supposed that under any circumstances all of the foreign balances in this country will be withdrawn or that the foreign central banks will withdraw their holdings without regard to possible effects upon the international situation, but the situation is new, and nobody knows to what extent these reserve holdings may be regarded as permanent. Even if withdrawn with great consideration, it is important that they shall be free to go without a corresponding contraction of credit.

Thus although our gold reserves are large the responsibilities of this money market are now worldwide, and the Reserve authorities are the guardians of the situation. While they are not likely to adopt any drastic measures it is even more improbable that they will themselves supply the basis for expanding credit under existing conditions.

Gold Movements

Reference has been made in preceding paragraphs to exports of gold since the first of the

year. The following table gives the figures by countries:

(000 omitted)

1928	January	February	March	3 Months' Total
Belgium	$ 2,000	....	....	$ 2,000
England	....	....	$ 1,000	1,000
France	7,500	$ 7,500	36,000	51,000
Germany	105	210	21,000	21,315
Italy	....	....	3,000	3,000
Netherlands	4,000	....	....	4,000
Argentina	19,750	12,000	19,700	51,450
Brazil	11,800	....	8,504	20,304
Uruguay	3,000	3,000	....	6,000
All Other	3,931	3,066	3,100	7,097
Total Exports	$52,086	$25,776	$92,304	$170,166
Total Imports	38,320	14,686	1,009	54,015
Net Exports..	$13,766	$11,090	$91,295	$116,151

It will be seen that the net loss of gold during March amounts to $91,295,000, one of the heaviest outward movements on record. Of this total $36,000,000 shipped to France has been stated to be from stocks previously earmarked for foreign account, hence not a factor in our credit situation. The remaining $56,000,000, however, presumably comes out of the money market.

With this month's exports, the total net loss for the quarter amounts to $116,151,000, including the $36,000,000 from earmarked stocks.

Aside from the $36,000,000 shipped to France, the principal exports were $19,700,000 to Argentina (bringing the movement to that country since last summer to $112,840,000), $8,504,000 to Brazil, and $21,000,000 to Germany. With sterling exchange at $4.88¼, a further shipment of $1,000,000 was made to London, supplementing a total of $8,548,000 shipped last December.

With the exception of the movement to the Argentine, these shipments do not represent ordinary exchange transactions but were induced by special considerations. The French movement will probably go on but these exports are from stocks already earmarked and no longer counted as part of our reserves. The United States does not face prospects of a serious drain on its gold stocks, but the movement is not one to be ignored.

The Bond Market

A broad and active bond market prevailed during most of the month of March as contrasted with reactionary tendencies during the latter part of February.

There were several developments during March which had an important bearing upon the upward course of bond prices, among which were the successful United States Treasury refinancing operation on a 3¼ per cent and 3⅜ per cent basis for short term certificates; the return of confidence in the stock market and resumption of heavy volume of trade at rising prices; the successful offering of New York City bonds on a yield basis lower than has prevailed for seventeen years; and passage by the New York State Legislature of bills enlarging the list of municipal and railroad bonds legal for savings banks and extending the general "legal" list to include bonds of certain gas, electric light and other public utility corporations. Heretofore the bulk of New York savings bank investments has been in high grade rails and municipals which have risen so high in market value that the yields were insufficient to justify the present interest rate on deposits. Broadening of the list will give the banks an opportunity to improve the earnings on their assets, for the time being at least.

The Dow Jones average for forty listed domestic corporate issues (10 high grade rails, 10 second grade rails, 10 industrials and 10 public utilities) on March 26th was 99.32 as compared with 99.06 on February 25th and 97.19 on March 26th a year ago. After having reached a low for the year of 98.99 early in March the average advanced rapidly to a point only slightly below the year's high record. A comparison of the averages for the various groups discloses a considerable adjustment marketwise as a partial result of the broadening of the New York "legal list" for savings banks. The average for the second grade rails and the public utilities, for instance, are now at new record levels, second grade rails at 100.37 and utilities at 98.16. The high grade rails, on the other hand, are hovering near the low for the year, 96.72 as compared with a high of 98.06.

European Recovery

In view of the public interest in the subject of American loans, and particularly the loans to Europe, up-to-date information about some of the earlier flotations is pertinent and instructive.

We are prompted to a brief review by the action of the Government of Czechoslovakia in calling for payment on April 1st the entire outstanding portion of the $25,000,000 7½ per cent twenty-year loan, sold in this market in 1925, and the fact that the payment will be made wholly from domestic resources. An internal loan at a 5 per cent coupon rate will provide most of the funds, but they will be supplied in part by surplus revenues. The offering here in 1925 was at 96 and interest, making the yield nearly 8 per cent. Evidently a pronounced change has come over credit conditions in Czechoslovakia in the last three years.

The first of that country's financing in the American market was the 8 per cent Sinking Fund Gold Loan of 1922, authorized to a total amount of $50,000,000, and offered simul-

taneously in New York, London and Amsterdam: $30,500,000 in 1922 and the balance in 1924. Of this amount $23,250,000 were originally sold in the United States; $14,000,000 in 1922 and $9,250,000 in 1924. Both portions were sold at 96½ to yield about 8.30 per cent. They are callable for the Sinking Fund at par, and as a whole at 108 per cent on or after May 1, 1932, and no doubt will be paid off at that date. These bonds are quoted at about 110¾, at which they yield about 6.67 per cent to the callable date, and would sell higher but for the callable feature.

The first of these Czechoslovakian loans was offered when this market was in the early stages of European financing, and skepticism toward all such financing was generally current. The reparations dispute was a menace to Europe and inflation was running wild almost everywhere except in Czechoslovakia, whose statesmen had shown exceptional ability in handling their financial problems. Czechoslovakia, however, was a new nation, and altogether conditions were not favorable to the placing of a loan in its behalf in the United States.

This was a case where bonds were placed largely upon the representations of bankers to their clients. The bankers based their action upon confidence in the resources of the country and the character of the people, and it is a source of gratification to them that the outcome has so well justified their opinions.

French Bonds

In 1915 the famous five-year $500,000,000 Anglo-French issue of the joint obligations of the British and French Governments was made in this market, the greatest open market international financing operation of all time. It was paid off at maturity, but in arranging for the payment the French Government placed a new issue of $100,000,000 of twenty-five year 8 per cent bonds. They were dated September 15, 1920, which was during one of the worst markets for a financial operation of such magnitude known in this country for many years. The terms included a condition that payment should be made in annual installments of 4 per cent of the principal at a premium of 10 per cent, hence $28,000,000 of the principal amount had been paid to September 15, 1927, at a premium of $2,800,000. The loan was callable at 110, and several months ago was called for payment on March 15, 1928. The funds for this final payment were supplied in the main by the Swedish Match Company, which has business relations with the French Government in connection with the French match monopoly, the transaction taking the form of a special bond issue by the French Government for the amount of $75,000,000, bearing 5 per cent interest, and running forty years. In carrying through this arrangement the Swedish Match Company provided a portion of the funds by means of a $50,000,000 bond issue by its American subsidiary, the International Match Company, on the New York market, this issue bearing 5 per cent interest and running twenty years. Thus the $100,000,000 French 8s have been retired and in their place the market holds $50,000,000 5 per cents issued by an American corporation.

Another French Government loan of $100,000,000, issued here in June, 1921, running 20 years, bearing 7½ per cent interest, was sold at 95, to yield over 8 per cent. Of this loan $39,194,500 has been retired to date, and the present market price of the bonds is 118⅜, to yield 5.50 per cent to maturity. A third French Government issue of $100,000,000 was sold here in 1924, running twenty-five years, bearing 7 per cent interest, priced at 94, to yield 7.53 per cent. Of this loan $13,259,000 has been retired to date, and the present market price is about 109⅛, to yield 6.23 per cent to final maturity.

The economic situation in France has undergone a great change for the better in the last two years. Not only has the currency been practically stabilized, but through the restoration of confidence and the return of capital to France the Government and its fiscal agent, the Bank of France, has come into possession of a great sum of foreign credits, sufficient to firmly establish the monetary system on a gold basis, supply ample capital for the industries and probably reestablish the country permanently in the creditor position which it occupied before the war. The discount rate of the Bank of France is 3½ per cent, which compares with 7 in 1926, 3½ at this time in Berne and Stockholm, but higher rates everywhere else in the world. Taxation is heavy, but the Government is demonstrating its ability to pay its way and make reductions on its indebtedness, the devastated regions are restored and the industries have greater productive capacity than ever before. The French nation is thoroughly solvent.

Belgian Bonds

The Belgian Government has six loans outstanding in this country, but only two date back of 1924. The first, for $50,000,000, was issued in 1920, bearing 7½ per cent, issue price 97¼. Upon this the sinking fund payments to date aggregate $16,100,000, representing retirements of $14,000,000 principal amount. Present market price of these bonds is about 115¾. The second loan of $30,000,000 was issued in 1921 at 100. Upon this sinking fund payments to date aggregate $10,125,000, and present market price of bonds is about 111.

Another issue of $50,000,000 in 1924, bearing 6 per cent was sold at 87½, to yield 7 per cent to maturity. Upon this sinking fund payments now aggregate $5,563,000, and the bonds now sell at about 100¾, to yield 5.94 per cent to maturity.

The Belgian currency was stabilized in October, 1926, the gold and gold exchange reserve was increased in 1927 and the Treasury was able to make a substantial reduction in the public debt. The industries of the country were to a great extent rebuilt after the war, are on a low-cost basis, and are able to compete with any in the world. The Government is carrying forward an extensive system of port works and canal construction to give the interior industries cheap access to the ports, with a view to serving export business. The industries are busy and the country prosperous.

German Borrowings

Of the German Government International Loan, sponsored by the Dawes plan and issued in 1924, $110,000,000 was placed in the United States. It runs for twenty-five years, bears 7 per cent interest and was sold at 92. Inasmuch as it was a part of the Reparations Plan it is secured by a first claim on all the revenues pledged to reparations and the payments upon it constitute a part of the fixed sums named as reparation payments. The interest yield on the issue price is about 7.70 per cent to maturity and the entire loan is being paid off monthly by the Agent-General of Reparations at the rate of one-twenty-fifth, or $4,620,000, annually, plus a premium of 5 per cent. Payments upon the American issue now aggregate $13,705,700 and the present market price of the bonds is about 107½, and would be higher but for the drawings for retirement.

The aggregate of private foreign borrowings by Germany is large, but inasmuch as they do not date back of 1925, sinking fund payments as yet are small. One of the early offerings in this country was that of $10,000,000 twenty-year 7 per cent gold debentures of the Allgemeine Elektricitäts Gesellschaft, or General Electric Company of Germany, issued in January, 1925, at a price to yield 7.70 per cent to maturity. The market price of these bonds has advanced to a point at which the yield is 6.55 per cent. On December 1, 1925, a second issue of debentures by this company was sold, bearing 6½ per cent, but carrying stock purchase rights entitling the bearer to purchase common shares of the company of 100 reichsmarks par value upon a graduated scale, ranging from $24 up to $34 per share. Thus $24 represents par for the common stock. These 6½ per cent debentures are now selling in this market without the stock warrants to yield 6.38 per cent, while the common stock is selling in Berlin at approximately 151.

This Company, which is one of the best known concerns of its kind in the world, has been steadily regaining its pre-war position in foreign trade. The total volume of business in the fiscal year ended September 30, 1927, was approximately 500,000,000 reichsmarks, exceeding that of the preceding year by more than 20 per cent. The volume of its exports exceeded that of the preceding year by 36 per cent, and was only 4 per cent under the pre-war volume. Net profits for the year exceeded 17,305,000 reichsmarks, against 14,671,000 in the previous year, and the dividend rate has been raised from 7 to 8 per cent.

Germany has made very substantial progress since the stabilization loan was granted in the latter part of 1924, but industrial recovery has accentuated the scarcity of working capital. The increasing reparation payments have been regularly made, and although it is frequently said that they have been made by means of foreign borrowing, this signifies nothing except as affording the means of transfer. There is no question as to Germany's having produced an economic surplus much in excess of the reparation payments. Savings Bank deposits, not to speak of other bank deposits or any other capital accretions, increased by about 1,500,000,000 reichsmarks in 1927, which compares with 1,750,000,000 reichsmarks, the total of reparation payments in the last annuity year. The aggregate production of German industries in 1927 probably was as great as in any year of the country's history.

Italian Borrowings

The principal item of Italian indebtedness in this country, aside from the war debt to the United States Government, is the stabilization loan of $100,000,000 placed here in 1925. It matures in 1951, was issued at 94½ to yield 7.48 per cent to maturity, and the bonds are now selling at about 99 to yield 7.09 per cent to maturity. This loan has a cumulative sinking fund sufficient to redeem the issue by maturity which went into effect September 1, 1926. The cities of Rome and Milan have loans of $30,000,000 each in this market, placed last year, both of which are selling in the market above their issue prices. Both of these loans have cumulative sinking funds sufficient to redeem the respective issues by maturity.

Private Italian borrowings have been for the development of the industries, electrical development leading.

Italy is reestablished on a gold basis, has a Treasury surplus of revenues over expenditures and in the last four years has accom-

plished a debt reduction from 96,270 million lira to 86,423 millions, or about 11 per cent.

Austria and Hungary

The stabilization loans to Austria and Hungary issued in 1923 and 1924 respectively, were negotiated by the League of Nations, and distributed in numerous countries, the allotments being issued in terms of the various currencies.

Both of these loans are secured by the pledge of revenues from certain sources, which have proved more than sufficient to meet the interest and sinking fund payments. The currencies of both countries are on a sound basis and the finances of both governments in good order. Austria has a difficult economic problem to solve on account of the disproportionate size of Vienna to the area, industries and population of the country, but the unemployment situation seems to be improving. Hungary was able to use a large part of the stabilization loan for productive purposes, particularly power development, with the result that economic conditions in the country now are very favorable.

Other International Loans

The dollar loans to the cities of Zurich and Berne, Switzerland, have been completely retired, although not actually maturing until 1945, new issues in the home market having been made for that purpose.

The 6 per cent dollar loan of the Mortgage Bank of the Kingdom of Denmark, which was sold here three years ago on a 6.05 per cent basis, was refunded in the latter part of 1927 with a 5 per cent issue on a 5.20 basis.

The proceeds of the recent 6 per cent issue of the Westphalia United Electric Power Corporation (Germany) sold on a 6.60 basis, are being applied in part to the retirement of that company's 6½ per cent issue of 1925, originally sold to yield 7.62.

The Republic of Finland in February sold in this market an issue of $15,000,000 of 5½ per cent bonds at 92½, to yield 6.04 per cent to maturity or 6.22 per cent to average expectancy of redemption from the sinking fund. The proceeds are being used to retire an issue originally sold in Norway, Sweden and Denmark in 1921. The first issue of Finland securities in the United States was made in 1923, upon a basis which yielded 6.89 per cent. These bonds are now selling to yield about 6.12 per cent to maturity.

The stabilization loan of $72,000,000 issued by Poland in 1927, part of which was placed in the United States and the remainder in several European markets, has placed the National Bank of Poland definitely upon the gold basis, and the ordinary budget has shown a credit balance over the last two years.

Evidence of General Improvement

The above review of bond issues is intended only to give a general idea of the status of the older and more important issues and of the general improvement which has taken place in the finances of European countries. The aggregate of repayments and repurchases in this market is far greater, as appears by the Department of Commerce figures which follow.

It is true that the repayments and repurchases do not signify a net reduction of our foreign loans, inasmuch as new ones are being made, but they show that existing obligations are being steadily liquidated according to their terms and are presenting no problem. Capital may be expected to flow outward on balance so long as higher returns are to be had abroad than at home, for the same reason that in past years caused a flow of European capital to the United States.

The flow of capital to Europe is not a permanent movement. Capital is accumulating there, and interest rates already have a downward trend. The fundamental condition of economic recovery was currency stabilization, and until this was accomplished private enterprise was without a safe basis for its activities. It is significant of general economic conditions that European production of steel was 25 per cent larger in 1927 than in 1926 and larger than in 1913.

Excepting the loans negotiated primarily for the purpose of obtaining gold for the reorganization of monetary systems, but little gold has left this country as the result of our foreign loans. The proceeds have remained here and been expended in the American markets. They have helped to sustain the buying power of Europe and the demand for American products during the period of European reorganization, as witness the increase of 32 per cent in our exports to Germany in 1927 over 1926.

The International Movement of Capital in 1926

Supplementing the above comments upon some of the earlier and best known loans, it is of interest to refer to the analysis which the United States Department of Commerce has made of the entire movement of funded capital between this country and other countries in 1926. This compilation and estimate is the result of a careful inquiry, made on a confidential basis, among financial houses concerned in international transactions, and although it does not purport to be complete or exact, it is obviously the best information available on the subject and sufficiently inclusive to give a good general idea of the situation.

MOVEMENT OF PRIVATE FUNDED CAPITAL

	Millions of Dollars Sales	Purchases
New American investments abroad*		1,332
Changes in previous American investments abroad:		
Bond redemption payments to Americans	250	
Sinking fund payments to Americans	20	
Resale to foreigners of direct investments	200	
Foreign stocks and bonds sold abroad**	286	
Foreign stocks and bonds bought from foreigners in small lots		115
New direct investments in United States by foreigners	32	
Changes in previous foreign investments in United States:		
Redemption and sinking-fund payments to foreigners		25
American stocks and bonds sold abroad	636	
American stocks and bonds bought abroad		509
Total	1,424	1,981
Balance		557

* Net sum (compiled and estimated) made available in foreign countries on account of publicly offered and privately taken foreign loans and direct American investments abroad, after deductions for refunding, for underwriters' commissions and for bond discounts.

** Some of these foreign securities are known to have been acquired earlier in 1926; so they are not exclusively "previous American investments abroad."

The excess of the increase in American investments abroad over the increase of foreign investments in this country is $557,000,000, which seems to represent the net gain in the American position during the year, having regard for investment holdings only. The computation, however, presents other factors, which, to avoid complexities, we will only summarize as follows:

The current exchange of miscellaneous goods and services and charges of all kinds during 1926, including merchandise, tourists' expenditures, immigrants' remittances, earnings of shipping, insurance companies, cable companies, banks, etc., interest and dividend payments, and both principal and interest payments received by the Government of the United States upon the indebtedness of foreign Governments, resulted in a net balance in favor of this country of $186,000,000. This seems surprisingly low, in view of our merchandise trade balance and interest income, but two items on the other side of the ledger, to wit, tourists' expenditures and immigrants' remittances, aggregating $983,000,000, more than offset the returns on all our foreign investments.

Furthermore, as against the favorable balance of $186,000,000 on current charges as described above, we received on balance $138,000,000 of gold bullion and United States currency, which would reduce the final balance on current account to only $48,000,000. According to the record this is all we had available from the actual exchanges with which to make the net foreign investment of $557,000,000. How did we manage to do it?

Increase of Foreign Deposits

The question is partly answered by the change in international bank accounts, as revealed by the official questionnaire. The excess of foreign deposits in American banks increased during the year by $359,000,000, which may be considered the remaining proceeds of foreign loans. In other words, at the end of the year we still owed that amount on the year's purchases of foreign securities. However, this increase in bank deposits, together with the $48,000,000 balance on current account, still fails to cover our gain of $557,000,000 in foreign securities, and the statisticians of the Department of Commerce admit their inability to account for the apparent discrepancy of $150,000,000. That they are unable to make the account balance only indicates the complexity of any such calculation.

The one conclusion that seems to be fully warranted is that we are not increasing our foreign investment holdings by $1,500,000,000 or $1,000,000,000 per year, as the figures of gross flotations are sometimes taken to indicate, or any sum approaching such figures. The tangible figures account for a gain of only $48,000,000 actually paid for in 1926, plus such part of the $150,000,000 discrepancy as may be applicable.

It is well known that European investors have bought largely of the European securities which have been offered in New York, at the time of the offerings and since. One explanation for this is that interest yields upon the large offerings in New York have been higher than yields upon securities of equal merit at prices current in home markets. New York has become a great flotation market, buying at wholesale and distributing to all countries.

Furthermore, it has become a reserve center, where surplus funds are kept on deposit or employed until wanted. It will be interesting to see the forthcoming compilation of the Department of Commerce upon capital movements in 1927, for there are good reasons for believing that the amount of foreign capital employed here was greater in 1927 than in 1926. The consolidated Federal Reserve statement for March 21, 1928, shows an item of "contingent liability on bills purchased for foreign correspondents," of $243,975,000, which compares with a like item of $147,946,000 on March 23, 1927.

British Overseas Investments

The British Government prepares an international balance sheet for Great Britain, similar to that of our Department of Commerce, although not given with so much detail, and the London Economist, comparing the two, arrives at the conclusion that in the seven

years 1920-26 the overseas investments of Great Britain increased by a larger net amount than the foreign investments of the United States. It comments as follows:

The United States, which was a debtor country before the war, but bought back its securities and became a creditor nation during the war, has not increased its net credit position in the last seven years as much as is commonly supposed. For though it has lent immense amounts abroad, a large part of these loans have been bought by foreigners, while foreigners have invested on a large scale in American securities, and there has been a great increase in foreign balances held in the U. S. A.

Great Britain, on the other hand, whose foreign investments before the war amounted to something in the neighborhood of £4,000 millions (20 billion dollars), lost some of these investments—or, to put the matter in another way, lived upon its capital during the war. During the last seven years, however, our net foreign investments have increased slightly faster than those of the United States, though not so fast as in prewar days.

In the case of both England and America the net export of capital has dwindled in recent years. In the case of the United States, the diminished export is significant in view of the fact that the low yield on American bonds and stocks is a reflection of an ample supply of internal capital in the country, and a shortage of good home securities. This low rate contrasts strikingly with the much higher yield on foreign securities. In the case of Great Britain, the 1926 figures are unduly low owing to the coal dispute.

The statement that the overseas investments of Great Britain have been growing faster than the foreign investments of the United States is so different from the current understanding that it scarcely seems credible, but the official estimates appear to support it. Foreign flotations in New York have largely exceeded those in London but the distribution and return flow apparently have been less from London than from New York.

The total of overseas flotations in London in 1927 is given as equivalent approximately to $740,000,000, but this includes an issue of stock by the Canadian Pacific Railway amounting to about $48,000,000, which was taken by its own stockholders. Although this is a British Company it is probable that one-half or more of the stock is held outside of Great Britain. The net balance of all payments to and by Great Britain in 1927 is estimated by the Government at £96,000,000 or a little under $480,000,000, which is taken to represent the net gain in the nation's international position.

The Economist computes the net increase of United States investments in the seven years at $3,232,000,000 and the corresponding figures for Great Britain at £862,000,000, or approximately $4,310,000,000. It should be mentioned also that at times, notably in 1925, when gold payments were resumed, and in 1926, when British exports were curtailed by the coal strike, foreign flotations on the London market were restricted, on the ground that they tended to promote gold exports and necessitated a higher bank rate to the disadvantage of British industry. This theory, however, ran counter to British experience and restriction has been practiced for only brief periods and on account of temporary conditions. The weight of opinion in Great Britain favors the view that the London money market has been a most potent factor in building up the great export business of the country.

The distribution of British overseas investments in 1927 as given by the London Economist, and converted at $5 to the £, is as follows:

	Average 1911-1913	1927
British Overseas Empire	$340,325,000	$503,025,000
U. S. A. and dependencies	122,065,000	19,735,000
Central and South America	221,880,000	109,570,000
Far East	47,840,000	5,300,000
Europe	75,520,000	103,780,000
	$807,630,000	$741,410,000

Distribution of Total American Investments Abroad

The manner in which Europeans are meeting their obligations and buying back their securities should be reassuring to those who have been inclined to view such investments with alarm. They should note also that less than one-third of our foreign investments are located in Europe. The Department of Commerce report for 1926 gives the following distribution of our total foreign investments as of the end of that year, but its estimate as of the end of 1927 is not yet available:

Europe	$3,010,000,000
Latin-America	4,500,000,000
Canada and Newfoundland	2,801,000,000
Asia, Australia, Africa and rest of world	904,000,000
Total	$11,215,000,000

The Department of Commerce report states that Europeans and Canadians have been the heaviest buyers of their own securities in our markets. Repurchases elsewhere are comparatively small.